HOUSING MARKET INFORMATION

# HOUSING MARKET ASSESSMENT

## Canada

**Date Released: Third Quarter 2018**

Canada

CMHC SCHL

## Highlights

- The Housing Market Assessment (HMA)[1] continues to indicate a high degree of overall vulnerability at the national level for the eighth consecutive quarter, due to price acceleration and overvaluation being detected.
- Housing markets for Vancouver, Victoria, Toronto and Hamilton remain highly vulnerable because of the detection of price acceleration and overvaluation. Most notably, high evidence of overvaluation is still observed in Vancouver, Victoria and Toronto where house prices remain higher than levels supported by economic and demographic fundamentals.
- The degree of overall vulnerability remains moderate for Edmonton, Calgary, Saskatoon and Regina, as these centres continue to show evidence of overbuilding.
- Though a low degree of vulnerability is maintained in the overall assessment for Montréal, rapid growth in house prices continues to be observed in certain neighborhoods. If strong growth in house prices were to persist, price acceleration could be signaled in a future HMA report.
- Winnipeg, Ottawa, Québec City, Moncton, Halifax and St. John's continue to receive a low rating of vulnerability in the overall assessment. However, evidence of overvaluation has changed from low to moderate for Winnipeg, as home prices continued to rise despite declines in real personal disposable income[2].

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[1] Results are based on data as of the end of March 2018 and market intelligence as of the end of June 2018. This national report provides the housing market assessment at the national level and summary assessment results for 15 Census Metropolitan Areas (CMAs). For each of these CMAs, CMHC also issues a local report with more information and analysis.

[2] Inflation-adjusted personal disposable income.

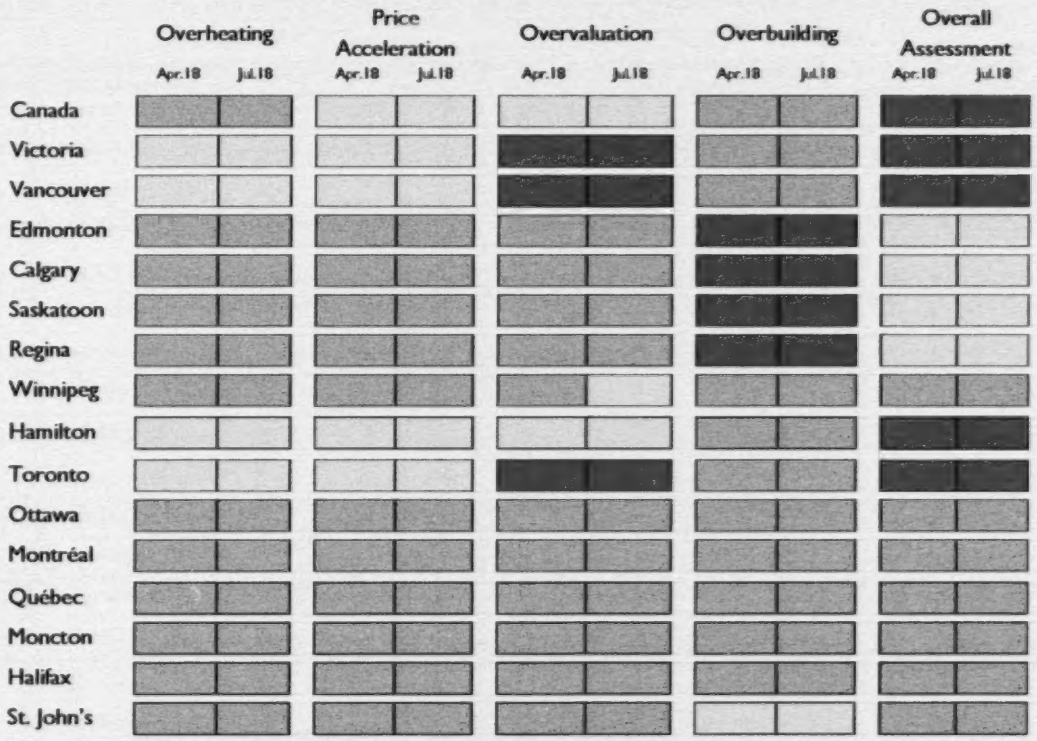
# Overview of HMA Results

The Housing Market Assessment (HMA) is an analytical framework that provides a comprehensive view of vulnerabilities to housing market instability. It contains four main factors: overheating, price acceleration, overvaluation and overbuilding.

*Overheating* is detected when sales greatly outpace new listings in the market for existing homes. *Price acceleration* is signaled when the growth rate of house prices increases rapidly. *Overvaluation* indicates that house prices are elevated compared to price levels supported by personal disposable income, population, interest rates, and other fundamentals[3]. *Overbuilding* is flagged when the rental apartment vacancy rate and/or inventory of newly built and unsold housing units are higher than normal.[4]

**Table 1**

**Comparisons between the April 2018 and July 2018 reports**




**Note 1:** Colour codes indicate the degree of market vulnerability. Overheating and price acceleration are measured by single indicators. Colour scales for these factors vary between green and yellow. Overvaluation and overbuilding are measured by multiple indicators. Their colour scales, as well as the colour scale for the overall assessment, change among green, yellow and red to reflect different degrees of imbalances.

**Note 2:** The HMA detects the presence or incidence of market imbalances when indictors are above thresholds. It also measures the intensity of signals by how much indicators are above thresholds, and the persistence of signals by how long signals stand above thresholds. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of imbalances increases.

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[3] Other fundamental factors include mortgage borrowing capacity of households, required minimum down payment, and labor productivity.

[4] More technical details on the HMA are provided in the Appendix.

# HMA Results for Canada

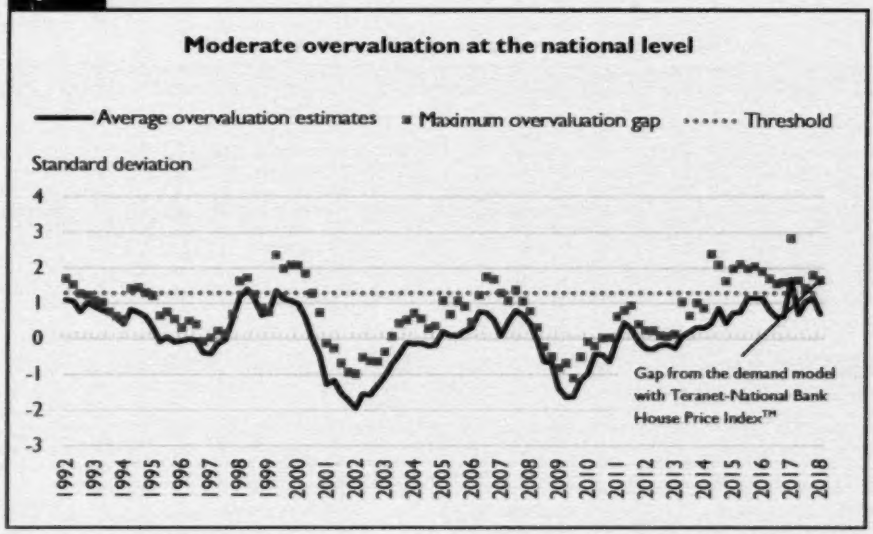
## Canada: ■ High degree of vulnerability

CMHC's HMA continues to indicate a high degree of overall vulnerability for the housing market at the national level for the eighth straight quarter. The rating is a result of both overvaluation and price acceleration being signaled.

Moderate evidence of overvaluation remains at the national level. As shown in Figure 1, the solid line, representing average overvaluation estimates from the selected models, lies below the critical threshold of overvaluation in the first quarter of 2018. However, our highest estimate of overvaluation[5] remains above the threshold. Therefore, according to the decision rule listed in the Appendix, moderate evidence of overvaluation for Canada as a whole is flagged, signaling that house prices are still elevated relative to prices supported by fundamental factors such as income and population.[6]

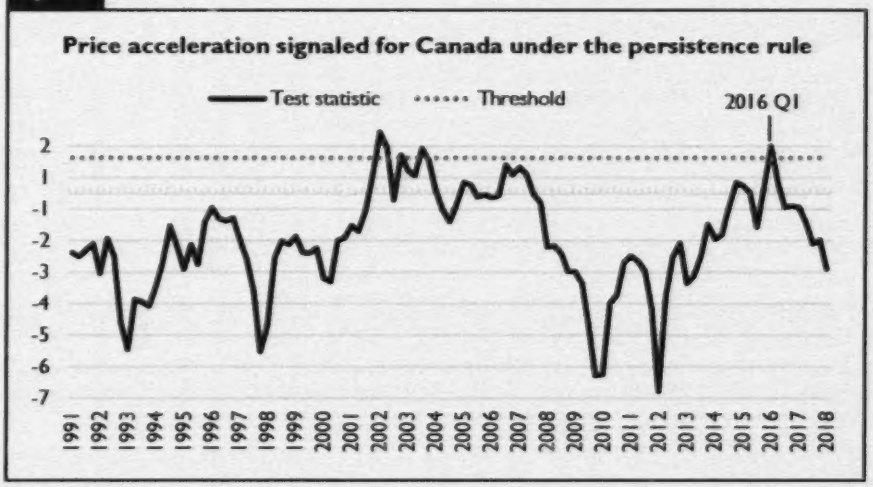
Evidence of price acceleration is maintained for Canada. Price acceleration occurs when growth in house prices keeps increasing for several quarters, which may cause expectations of future house price growth. This can attract investors who want to benefit primarily from short-term capital appreciation, leading to further acceleration in house prices. That is, speculative activities can feed on themselves and thus push house prices further in an upward spiral. The HMA uses a statistical test to identify accelerating house prices. As shown in Figure 2, price acceleration was

Figure 1




Sources: CREA, Statistics Canada, Teranet and National Bank of Canada, and calculations by CMHC.
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. These include demand, supply, hybrid, and affordability models, each of which is estimated using four measures of house prices to generate sixteen unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Ordinary Least Squares (DOLS). The maximum overvaluation gap is obtained from the model that has the largest gap between the actual price and the estimated price. The threshold is fixed at a critical value of 1.29 for a confidence level of 80%. Overvaluation is signaled when overvaluation estimates lie above the threshold.

Figure 2




Source: CREA and calculations by CMHC.
Note: The test is done using the MLS® average price. Other price indices are also monitored.

[5] The highest estimate of overvaluation is obtained from the demand model with Teranet-National Bank House Price Index™.

[6] After adjusting for inflation, the Teranet-National Bank House Price Index™ increased by 5.5%, while personal disposable income and the young adult population increased by 1.8% and 1.7%, respectively, in the first quarter of 2018 from a year ago.

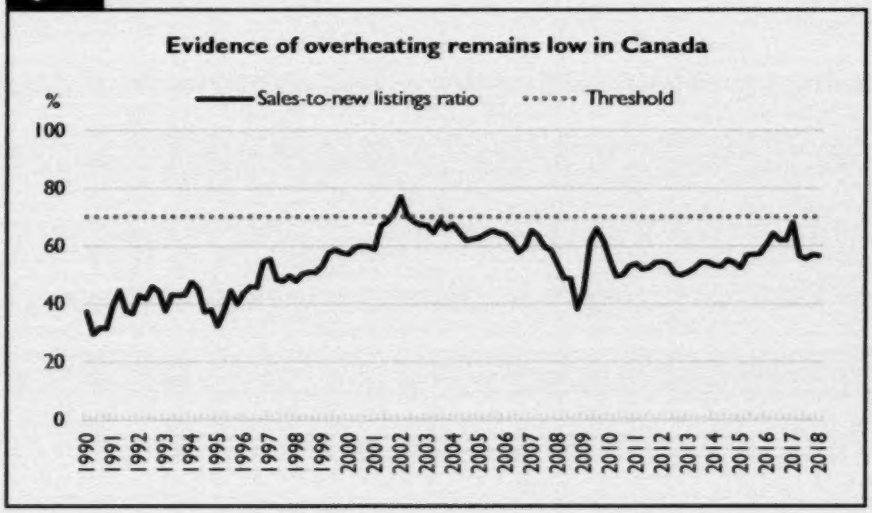
detected in the first quarter of 2016. Though the real MLS® average price[7] decreased by 6.7% in the first quarter of 2018 from a year ago, the moderate rating is kept for three years according to the decision rule listed in the Appendix. This accounts for the possibility that expectations of future house-price appreciation may persist for a period of time.

Low evidence of overheating and overbuilding are observed for Canada as a whole since indicators were below their respective thresholds. The sales-to-new listings ratio was 56.6% in the first quarter of 2018, almost the same as in the fourth quarter of 2017 (Figure 3). The inventory of housing units per 10,000 population further edged down to 3.8 units in the first quarter of 2018 from 3.9 units in the previous quarter (Figure 4), while the annual rental apartment vacancy rate dropped to 3.0% in late 2017 from 3.7% a year before (Figure 5).

The degree of overall vulnerability is assessed by considering the combination of price acceleration, overvaluation and overbuilding. There is coexistence of overvaluation and price acceleration in Canada. This suggests that, not only are house prices elevated compared to levels supported by fundamentals, excessive expectations of future house-price growth may themselves push house prices further above the fundamental levels. Thus, Canada is rated as having a high degree of vulnerability for the overall assessment.

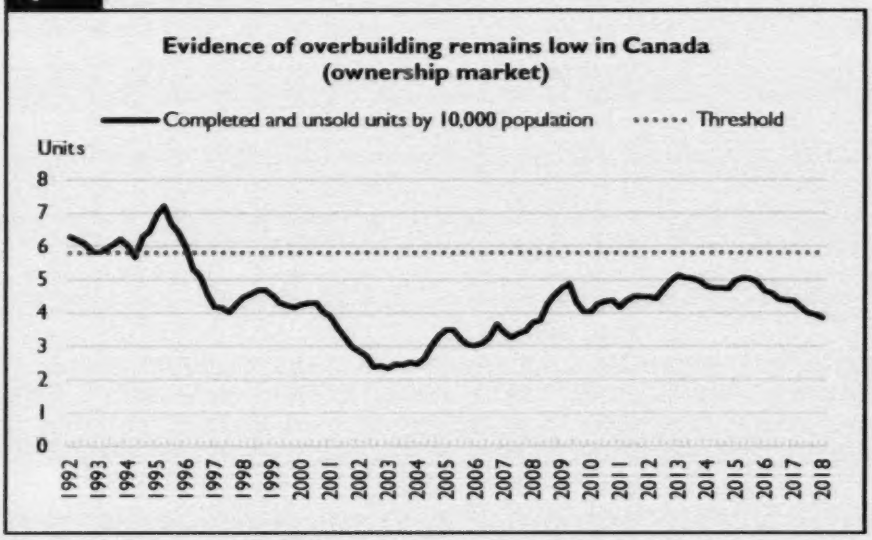
Regional disparities persist, especially in terms of overvaluation and overbuilding. A high degree of overall vulnerability is maintained for Vancouver, Victoria, Toronto and Hamilton with price acceleration and overvaluation being signaled. Most notably, high evidence of overvaluation is observed in Vancouver, Victoria and Toronto where house prices remain higher than levels estimated by the fundamental factors.

Figure 3




Source: CREA and calculations by CMHC.
Note: The sales-to-new listings ratio is the number of existing home sales divided by the number of new listings entering the market.

Figure 4

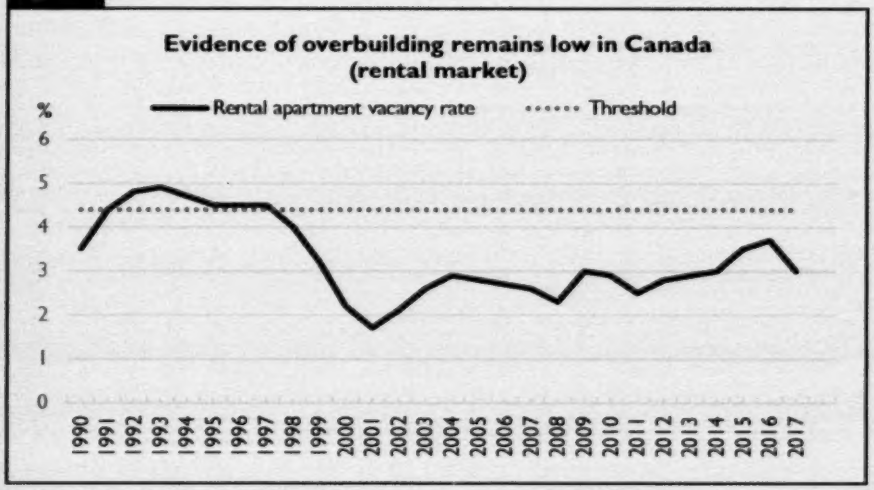



Sources: Statistics Canada and CMHC.
Note: Overbuilding is signaled when the supply of readily available housing units significantly exceeds demand. This figure presents one of the two indicators the HMA uses to assess overbuilding conditions in the housing market: the inventory of newly completed but unsold housing units per 10,000 population.

House prices are broadly in line with the price levels supported by the fundamentals in Edmonton, Calgary, Saskatoon and Regina. However,

[7] Inflation-adjusted MLS® average price.

Figure 5




Source: CMHC, Rental Market Survey (RMS).
Note: Overbuilding is signaled when the supply of readily available housing units significantly exceeds demand. This figure shows one of the two indicators the HMA uses to assess overbuilding conditions in the housing market: the rental apartment vacancy rate. CMHC conducts the RMS every year in October. The last data point presented in this figure is from October 2017.

evidence of overbuilding stays high in these four centres, with both the inventory of completed and unsold housing units and the vacancy rate for rental apartments above overbuilding thresholds. Hence, they continue to receive a moderate overall assessment of vulnerability.

While Montréal is evaluated as showing a low degree of vulnerability, rapid growth in house prices continues to be observed in certain neighbourhoods. If the rate of price growth were to continue to accelerate in Montréal as a whole, the rating of price acceleration could be raised to moderate in a future HMA report.

The HMA continues to assign a low rating of overall vulnerability for Winnipeg, Ottawa, Québec City, Moncton, Halifax and St. John's. However, evidence of overvaluation has changed from low to moderate for Winnipeg, since home prices increased to levels above prices explained by the fundamentals.

# HMA Summary Results for 15 Census Metropolitan Areas (CMAs)

## Victoria: ■ High degree of vulnerability

Existing home sales in Victoria trended down in the first quarter of 2018, allowing inventories to rise from a historic low point. Similarly, completed and unsold units trended away from the low point a year ago as the historically high level of units under construction started to come to market. However, strong evidence of overvaluation persists, as price growth remains elevated.

## Vancouver: ■ High degree of vulnerability

The Vancouver CMA housing market continues to show a high degree of vulnerability. Overheating and price acceleration continue to be indicated due to the persistence rule. Despite falling prices at the high end of the resale market, rising mortgage rates coupled with price growth at the lower end of the market continue to drive the detection of strong evidence of overvaluation by the HMA. Low inventories of completed and unsold new homes and a low vacancy rate in the rental market suggest that there is weak evidence of overbuilding.

## Edmonton: □ Moderate degree of vulnerability

Strong evidence of overbuilding persisted in the Edmonton housing market between the fourth quarter of 2017 and the first quarter of 2018. The inventory of completed and unsold new homes on the market remained above the level indicating overbuilding. While evidence of overvaluation in the Edmonton housing market remains low, some indicators are trending closer to problematic thresholds. CMHC's HMA framework continues to indicate low evidence of overheating and price acceleration in the Edmonton housing market.

## Calgary: □ Moderate degree of vulnerability

The inventory of completed and unsold units remains near a historically high level, contributing to strong evidence of overbuilding. Condominium starts, in particular, have continued to rise in 2018 despite buyers' market conditions in the resale market for similar existing units. There is little evidence of critical threshold breaches among the other HMA factors.

## Saskatoon: □ Moderate degree of vulnerability

Downward pressure on several house price measures persisted during the first quarter of 2018,

resulting in continued low evidence of overvaluation in Saskatoon's market. Meanwhile, the inventory of completed and unsold units per 10,000 population dropped below the critical threshold for the first time in three years over the same period.

## Regina: □ Moderate degree of vulnerability

House prices in Regina continue to be closely aligned with the price levels predicted by fundamentals. Therefore, evidence of overvaluation remains low. Following a strong performance in housing starts during 2017, the inventory of completed and unsold units per 10,000 population increased further above the critical threshold in the first quarter of 2018. Combined with an elevated rental vacancy rate, this resulted in the HMA framework's continued assessment of high evidence of overbuilding in Regina's market.

## Winnipeg: ■ Low degree of vulnerability

The HMA framework continues to detect a low degree of overall vulnerability in the Winnipeg CMA. However, the level of overvaluation has moved from low to moderate as house prices have moved above levels suggested by economic fundamentals. Home prices have continued to rise despite declines in real personal disposable income and a gradual increase in mortgage rates. While the evidence of overbuilding remains low, the inventory of completed and unsold units increased and was above the threshold for overbuilding in the first quarter of 2018, though this was largely driven by increases in the single-detached market. There was no change to the assessment for overheating or price acceleration.

## Hamilton: ■ High degree of vulnerability

The HMA framework continues to detect moderate evidence of overheating, price acceleration and overvaluation in the Hamilton housing market. However, the degree of overvaluation lessened as house prices became more reflective of the fundamental drivers of housing demand. Fundamentals such as population growth and employment held up better than prices which decreased in the first quarter of 2018.

## Toronto: ■ High degree of vulnerability

Sales continued to trend lower in the first quarter of 2018, pushing the sales-to-new listings ratio well below the threshold for overheating. However, the moderate rating for overheating is maintained because of the persistence rule.

We continue to detect moderate evidence of price acceleration. The real MLS® average price declined in the first quarter of 2018 from the previous quarter. Due to their weight in terms of dollar value, the drop in sales and decline in the average price of single-detached homes continued to weigh on the overall average price. Despite price growth slowing across the Greater Toronto Area, lower house prices would have to persist longer in order for us to discount any evidence of price acceleration. Therefore, the moderate rating of price acceleration is maintained due to the persistence rule. Market conditions for condominium apartments have continued to remain tight thus resulting in stronger price growth for this housing type. Further, we continue to detect high evidence of overvaluation in the Toronto CMA.

## Ottawa: ■ Low degree of vulnerability

There is low evidence of vulnerability for all four factors in Ottawa. However, the sales-to-new listings ratio has been trending up since mid-2016, while remaining below the threshold for evidence of overheating. While recent monthly data suggest that the trend has moderated, market conditions remain in sellers' territory. Evidence for price acceleration and overvaluation also remain below critical thresholds despite stronger price growth in recent quarters. With housing demand strengthening in Ottawa since 2017, the number of completed and unsold units has trended down over the same period, indicating low evidence of overbuilding. Nevertheless, the number of units under construction has trended up for three consecutive quarters, and surpassed its peak in the third quarter of 2013. As a result, indicators of overbuilding will continue to be closely monitored.

## Montréal: ■ Low degree of vulnerability

For a sixth consecutive quarter, the degree of overall vulnerability remains low in the Montréal CMA housing market. The level of personal disposable income, combined with acceleration of population growth among young adults, indicates that house prices are supported by the fundamentals.

Nevertheless, given the sharp tightening between supply and demand, the Montréal resale market is increasingly approaching overheating, which creates significant upward pressure on prices. Indicators of overheating and price acceleration will therefore have to be carefully monitored over the next few quarters.

Evidence of overbuilding remains low, as the inventory of completed and unsold condominiums continues to be relatively low, while the rental apartment vacancy rate reached 2.8% in 2017, recording its strongest decline in over 15 years.

## Québec: ■ Low degree of vulnerability

The degree of vulnerability of the housing market in the Québec City area remains low. Overall, house prices remained close to levels supported by economic and demographic fundamentals. Evidence of overvaluation therefore remains low. In addition, we did not detect any evidence of overheating or price acceleration, given relatively abundant supply on the resale market and the slight downward trend in prices (when adjusted for inflation).

Furthermore, the inventory of completed and unsold properties and the vacancy rate for rental apartments were below the thresholds that would indicate overbuilding. It should be noted, however, that there is a significant number of units under construction or recently completed in the rental market that will rapidly increase supply in the region and in turn put upward pressure on the vacancy rate. The conditions of the rental market will therefore be the subject of continued monitoring.

## Moncton: ■ Low degree of vulnerability

The sales-to-new listings ratio decreased slightly in the first quarter of 2018, remaining below the threshold. As a result, there remains little evidence of overheating. Buoyed by increased immigration and improved labor market conditions, monthly home sales in the Moncton CMA are setting records, while listings remain at historical multi-year lows and continue to fall. Most new homes in the Moncton CMA are currently being sold upon completion. The indicators of overbuilding, price acceleration and overvaluation remain below their thresholds for vulnerable conditions.

## Halifax: ■ Low degree of vulnerability

Overall, there is low vulnerability in the Halifax CMA. The inventory of completed and unsold units decreased in the first quarter of 2018 and remains below the threshold. This is largely due to strong MLS® sales so far this year, which increased by 14% in the first quarter compared to a year ago. Listings have remained low. Consequently, the sales-to-new listings ratio increased in the first quarter but remains below the threshold. The overbuilding indicator had been rising since the third quarter of 2016 and peaked in the third quarter of 2017, but has since decreased and is below the threshold. Overbuilding could be a concern in the near future if sales do not remain as strong as they have been so far in 2018. The price acceleration, overvaluation and overheating indicators all remain below their thresholds.

## St. John's: ■ Low degree of vulnerability

There is low vulnerability in the St. John's CMA. Stability continues within the local housing market, with some areas of the St. John's CMA showing little change in prices and year-over-year growth only in certain neighborhoods. Housing starts, however, are very low and the inventory of completed and unsold units relative to the population has now declined for the last two quarters. Stable housing market activity overall is attributed to a lack of growth in disposable income and the number of young adults.

# Appendix

## What is CMHC's Housing Market Assessment?

The objective of CMHC's Housing Market Assessment is to identify locations in which there are heightened vulnerabilities to housing market instability from the level of house prices and/or from factors that are known to influence house prices.

The HMA is an analytical framework that provides a comprehensive view of housing market vulnerabilities, relying on a combination of indicators of housing market conditions for several metropolitan areas across Canada, and for Canada as a whole[8].

Specifically, the framework considers four main factors with different possible degrees of vulnerability[9] that may provide an early indication of imbalances in housing markets:

1. **Overheating:** Sales greatly outpace new listings in the market for existing homes.

   □ Moderate: Sales-to-new listings ratio lies above the threshold of overheating for at least two quarters over the past three years.

   ■ Low: Otherwise.

[8] The data for Canada include areas beyond the 15 CMAs covered in this report.

[9] The colour scale extends to red only for those factors that have multiple indicators that identify imbalances. As a result, only overvaluation and overbuilding could potentially receive a red rating, since they are assessed with more than one indicator.

2. **Sustained acceleration in house prices:** Fast-rising prices often indicate that expectations of future house-price appreciation may be excessive.

   ☐ Moderate: The Augmented Dickey-Fuller (ADF) test statistic stands above the critical threshold for at least one quarter during the past three years.

   ▩ Low: Otherwise.

3. **Overvaluation:** House prices are higher than levels supported by personal disposable income, population, interest rates, and other fundamentals.

   ■ High: The average of the gaps obtained from a group of selected models is above the critical threshold for at least two quarters during the past year. The gap measures the distance between the actual price and the price level estimated from fundamental variables of housing markets.

   ☐ Moderate: At least one of the selected models exhibits overvaluation.

   ▩ Low: Otherwise.

4. **Overbuilding:** Inventory of newly built and unsold housing units and/or rental apartment vacancy rate are higher than normal.

   ■ High: The inventory of newly completed and unsold units is above the threshold for at least two quarters during the past year, while the annual rental apartment vacancy rate is also above the threshold.

   ☐ Moderate: Either the inventory of newly completed and unsold units is above the threshold for at least two quarters during the past year or the rental apartment vacancy rate is above the threshold.

   ▩ Low: None of the previous conditions is present.

**Overall assessment:** Assess the degree of market vulnerability considering the combination of multiple factors.[10]

■ High: More than one factor of price acceleration, overvaluation or overbuilding exhibits moderate or strong evidence of imbalances.

☐ Moderate: The rating reflects three scenarios. The first is when the overall assessment is red in the past six quarters. The second is when only one of the factors of overbuilding or overvaluation is assessed red for at least two quarters during the past year. The last is when one factor is showing moderate evidence of imbalances, but another factor lies slightly below the threshold.

▩ Low: Otherwise.

The framework takes into account economic, financial and demographic determinants of the housing market such as personal disposable income, interest rates and population to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

[10] The framework was tested against CMHC's mortgage insurance claims rate. The results show that the detection of more than one HMA factor is more problematic for insurance claims than the detection of just one factor. Therefore, the individual factors are jointly analysed to provide an overall assessment of the state of a given housing market, which is rated on our three-coloured scale (green, yellow, and red).

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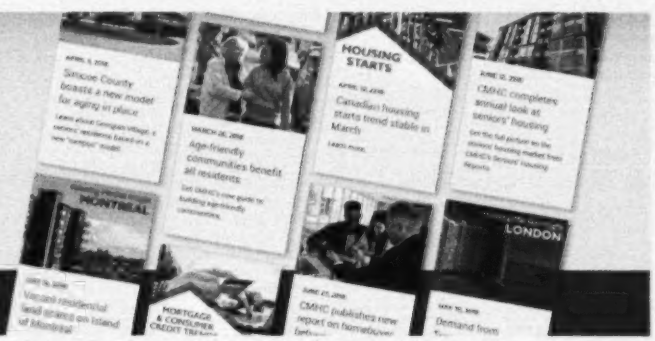


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